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No. 07-336

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In the

Supreme Court of the United States

NATIONAL WINE AND SPIRITS, INC, NWS MICHIGAN, INC, and NATIONAL WINE & SPIRITS, LLC,

Petitioners,

v

STATE OF MICHIGAN and MICHIGAN BEER AND WINE WHOLESALERS ASSOCIATION,

Respondents.

On Petition for a Writ of Certiorari to the Michigan Court of Appeals

BRIEF FOR THE STATE OF MICHIGAN IN OPPOSITION

Michael A. Cox
Michigan Attorney General

Thomas L. Casey
Michigan Solicitor General
Counsel of Record
P. O. Box 30212
Lansing, Michigan 48909
(517) 373-1124

Howard E. Goldberg
Assistant Attorney General

Attorneys for Respondent
State of Michigan

QUESTION PRESENTED

As part of its three-tier in-State wine distribution system, Michigan has historically recognized geographic distribution areas and has had a residency requirement for wine wholesalers. In *Granholm v Heald*, 544 US 460 (2005) and prior cases, this Court has explicitly recognized the constitutionality of such a three-tier system. In 1996 the Michigan Legislature created a new and separate system for distribution of spirits. It recognized existing economic reliance interests and residency and geographic distribution requirements, and attempted to create a level playing field by, among other things, prohibiting spirit distributors from becoming wine wholesalers in geographic areas in which another wine wholesaler had already been appointed before the statutory change. Petitioners include a licensed Michigan resident spirit distributor/wine wholesaler that seeks to become a wine wholesaler in geographic areas in which other wine wholesalers had already been appointed before the statutory change.

Does the Michigan in-State alcohol distribution structure, which statutorily recognized existing economic reliance interests by imposing limitations on spirit distributors who are also wine wholesalers, violate the Commerce Clause?

PARTIES TO THE PROCEEDING

There were no parties to the proceedings below other than those identified in the caption of the case.

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OPINIONS AND ORDERS BELOW

The opinion of the Michigan Court of Appeals is unpublished (Pet. App. 1-14). The Order of the Michigan Supreme Court vacating its grant of leave to appeal is published at 477 Mich 935; 723 NW 2d 834 (2006) (Pet. App. 29-44). The Order of the Michigan Supreme Court denying petitioners' motion for reconsideration is published at 477 Mich 1088; 729 NW 2d 234 (2007) (Pet. App. 15-28).

JURISDICTION

The judgment of the Michigan Court of Appeals was entered on March 25, 2004. The Michigan Supreme Court granted leave to appeal on January 20, 2006, but later vacated its order and denied leave to appeal on November 29, 2006. The Michigan Supreme Court denied petitioners' motion for reconsideration on April 11, 2007. The jurisdiction of this Court is invoked under 28 USC § 1257.

CONSTITUTIONAL PROVISIONS, STATUTES, AND COURT RULES INVOLVED

US Const, Amend XXI, § 2:

> The transportation or importation into any State, Territory, or possession of the United States for delivery or use therein of intoxicating liquors, in violation of the laws thereof, is hereby prohibited.

Mich Const 1963, art 4, § 40:

> A person shall not sell or give any alcoholic beverage to any person who has not reached the age of 21 years. A person who has not reached the age of 21 years shall not possess any alcoholic beverage for the purpose of personal consumption. An alcoholic beverage is any beverage containing one-half of one percent or more alcohol by volume.
>
> Except as prohibited by this section, (t)he legislature may by law establish a liquor control commission which, subject to statutory limitations, shall exercise complete control of the alcoholic beverage traffic within this state, including the retail sales thereof. The legislature may provide for an excise tax on such sales. Neither the legislature nor the commission may authorize the manufacture or sale of alcoholic beverages in any county in which a majority of the electors voting thereon shall prohibit the same.

Michigan Liquor Control Code, Mich Comp Laws (MCL) 436.1205(3):

> An authorized distribution agent shall not have a direct or indirect interest in a supplier of spirits or in a retailer. A supplier of spirits or a retailer shall not have a direct or indirect interest in an authorized distribution agent. An authorized distribution agent shall not hold title to spirits. After September 24, 1996, an authorized distribution agent or an applicant to become an authorized distribution agent who directly or indirectly becomes licensed subsequently as a wholesaler shall not be appointed to sell a brand of wine in a county or part of a county for which a wholesaler has been appointed to sell that brand under an agreement required by this act. A wholesaler who directly or indirectly becomes an authorized distribution agent shall not sell or be appointed to sell a brand of wine to a retailer in a county or part of a county for which another wholesaler has been appointed to sell that brand under an agreement required by this act, unless that wholesaler was appointed to sell and was actively selling that brand to retailers in that county or part of that county prior to September 24, 1996, or unless the sale and appointment is the result of an acquisition, purchase, or merger with the existing wholesaler who was selling that brand to a retailer in that county or part of that county prior to September 24, 1996.

Michigan Liquor Control Code, MCL 436.1601(4):

> A wholesale licensee or an applicant for a wholesale license, if a corporation, shall be licensed only if the corporation is authorized to do business under the laws of this state and if all stockholders of the corporation have resided in this state for not less than 1 year immediately preceding the date of issuance of the license. A corporation that holds a wholesale license shall not issue shares of the corporation's stock to a person who has not resided in this state for at least 1 year immediately preceding the date on which the corporate stock was acquired by the person.

STATEMENT OF THE CASE

This is a suit by Michigan residents who are both Authorized Distribution Agents for spirits and licensed wine wholesalers (ADA/wholesalers), challenging the statute that generally prohibits such entities from wine wholesaling in a geographic area in which another wine wholesaler had already been appointed before a statutory change in 1996.

The Michigan Distribution System

Michigan has a "three tier" system for wine distribution. The tiers consist of suppliers (i.e., winemakers), wholesalers, and retailers. Wine is distributed by privately-owned licensed in-State wholesalers, who have contracts with suppliers for specific limited sales territories and who market wine

products to retailers. Wine wholesalers must be Michigan residents. MCL 436.1601(4). Two wine wholesalers can have the same distribution rights for a particular wine brand in the same geographic territory; this practice is commonly referred to as "dualing" of wine distribution rights. "Dualing" is the exception in Michigan; most wine is distributed by only one wholesaler in a given geographic territory. In reliance on Michigan's long-standing regulatory framework, wine wholesalers have and must maintain substantial investments in warehouses, trucks and employees.

In contrast to the wine distribution system, Michigan is a "control" State with regard to the distribution and sale of spirits (hard liquor) to retailers. Michigan purchases spirits from suppliers and requires retailers, in turn, to buy from the State at prices set by the State. This ensures State control and generates significant revenue for Michigan. Until 1996, the warehousing and distributing of spirits was performed by State employees using State facilities. In 1996, the Michigan Legislature allowed the State to utilize private entities, known as Authorized Distribution Agents (ADAs), to perform the warehousing and distribution functions previously performed by State employees. ADAs are State agents, through whom suppliers of spirits must distribute and from whom retailers of spirits must purchase. ADAs do not own the spirits they distribute; they are owned by the State. The State unilaterally sets the compensation for ADAs, the State gives the ADAs access to the retail market, and the State regulates ADAs by statute, administrative rules, and administrative orders. Unlike wine wholesalers, ADAs

receive State payments for warehousing and distribution of spirits.

When the Michigan Legislature adopted the ADA system in 1996, it preserved the economic reliance interests of existing wine wholesalers. It prohibited an ADA, such as Petitioner NWS Michigan, Inc.,[1] who also becomes licensed as a wine wholesaler, such as Petitioner National Wine & Spirits, LLC,[2] from wholesaling a brand of wine to retailers in a territory where another wine wholesaler had already been appointed for that brand of wine, unless that brand was being wholesaled by the ADA/wholesaler on or before September 24, 1996. MCL 436.1205(3).[3] Had the Legislature not done so, the new ADA/wholesaler entities, using their State payments, would have been able to achieve significant economies of scale—by consolidating warehousing and distribution facilities

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[1] Petitioner NWS Michigan is a wholly-owned subsidiary of petitioner, National Wine & Spirits, Inc., an Indiana company. It became a Michigan corporation on October 21, 1996. The Michigan Liquor Control Commission appointed it an authorized distribution agent (ADA) pursuant to MCL 436.1205(3) to store and deliver spirits for the State of Michigan on December 22, 1996.

[2] Petitioner NWS Michigan, Inc., controls petitioner National Wine & Spirits, LLC, a Michigan limited liability company, which became a licensed wine wholesaler in Michigan on November 12, 1999.

[3] MCL 436.1205(3) was given immediate effect on December 19, 1996 and provides in part:

> After September 24, 1996, an authorized distribution agent . . . who directly or indirectly becomes licensed subsequently as a wholesaler shall not be appointed to sell a brand of wine in a county or part of a county for which a wholesaler has been appointed to sell that brand under an agreement required by this act.

for both spirits and wine, for example—when compared to existing wine wholesalers that did not become ADAs.

Proceedings below

In 2002, nearly six years after NWS Michigan became an ADA, and three years after National Wine & Spirits, LLC became licensed as a wine wholesaler, Petitioners filed an action in a State circuit court challenging the constitutionality of MCL 436.1205(3). Petitioners argued below that the statute is unconstitutional on its face because it denies them equal protection of the law under the Michigan and United States Constitutions by prohibiting an ADA/wine wholesaler from being appointed to represent a brand of wine in a specific territory where that brand is already represented by another wholesaler, unless the ADA/wine wholesaler was doing so prior to September 24, 1996. The circuit court held that the Legislature had a legitimate purpose in enacting MCL 436.1205(3): the preservation of the structure of an orderly and stable wholesale wine distribution system that furthers the State's interests and policies. The court further determined that the classifications set forth in MCL 436.1205(3) rationally serve that purpose in that it "grandfathered" pre-existing wine distribution rights because wholesalers had made investments in, built up, and promoted those particular wine brands in particular geographic areas. The court also held that the statute's regulation of Michigan's wine distribution system implicates powers reserved to the States by the Twenty-first Amendment to the United States Constitution and that MCL 436.1205(3) does not run afoul of the Commerce Clause. The circuit court held that MCL

436.1205(3) does not discriminate against interstate commerce or out-of- entities on its face or in its application.

The Michigan Court of Appeals affirmed the trial court's decision on March 25, 2004 (Pet. App. 1-14). Petitioners then sought leave to appeal to the Michigan Supreme Court.

Petitioners filed an application for leave to appeal to the Michigan Supreme Court, which issued an order holding the application in abeyance pending issuance of this Court's decision in *Granholm v Heald*.[4] After this Court issued its decision in *Granholm*, the Court heard oral argument on whether to grant the application, then granted the application, then heard oral arguments on the merits, then issued an order vacating its grant of leave to appeal as improvidently granted. (Pet. App. 29-44). A motion for reconsideration was then denied. (Pet. App. 15-28).

REASONS FOR DENYING THE WRIT

Reduced to its essence, Petitioners' challenge to the Michigan statutes is that even though Petitioner National Wine & Spirits, LLC, a Michigan resident, chose not to become licensed as a wine wholesaler until 1999, the residency and geographic distribution requirements that were in effect both before and after a 1996 statutory amendment violate the Commerce Clause. However, they did not directly make such a challenge in the Michigan courts—indeed, they

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[4] *Granholm v Heald*, 544 US 460 (2005).

expressly disavowed doing so.[5] Their only challenge in this Court is based on a mischaracterization of the opinion in *Granholm v Heald*, broadly asserting that the decision prohibits all discrimination "against out-of-state interests."[6] This, according to Petitioners, invalidates Michigan's statutes concerning in-State spirit distribution and wine wholesaling. *Granholm*, however does not stand for such a sweeping proposition—to the contrary, it supports Respondents. Nothing in the Michigan system violates the Commerce Clause. There is no reason to remand the case to the Michigan courts, and there is no reason to grant certiorari.

I. THE MICHIGAN DISTRIBUTION SYSTEM DOES NOT VIOLATE THE COMMERCE CLAUSE

A. *Granholm* Does Not Assist Petitioners.

In *Granholm v Heald* this Court held that Michigan and New York laws preventing out-of-State wineries from making direct retail sales and shipments to in-State customers, but permitting some in-State wineries to do so, violated the dormant Commerce Clause.[7] Petitioners, however, are licensed Michigan residents that are neither wineries nor consumers. They are State-licensed, State-resident middlemen distributors. This case does not involve discrimination against out-of-State products or producers in favor of Michigan products or producers. This case only

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[5] Michigan Supreme Court order denying reconsideration. Markman, J., concurring, 477 Mich at 1089; 729 NW 2d at 236 (2007) (Pet. App. 17-18)

[6] Petition, at 14.

[7] *Granholm v Heald*, 544 US at 466.

involves how ADAs may function if they want to be both an agent for spirits distribution, and a licensed wine wholesaler. This case involves only the structure of Michigan's in-State spirits and wine distribution systems and what type of distribution rights Michigan gives to in-State entities operating wholly within the structure of those systems.

Petitioners do not assert interests or claims of the type that were at issue in *Granholm*. Nor do they even allege that any out-of-State wine is barred from Michigan markets. To the contrary, Petitioner National Wine & Spirits, LLC complains because it may not have "dual" appointments to distribute wine that already reaches Michigan consumers through other wine wholesalers. There is no out-of-State producer whose prices are regulated by MCL 436.1205(3), no out-of-State wine that is barred from Michigan by MCL 436.1205(3), and no tax levied on foreign wine but exempted for Michigan brands. There is no supplier whose products are barred by MCL 436.1205(3).

Granholm and the cases it relies upon do not support Petitioners. To the contrary, *Granholm* reiterates a principle that defeats their claims[8]

> The Twenty-first Amendment grants states virtually complete control over . . . how to structure the liquor distribution system. . . . State policies are protected under the Twenty-first Amendment when they treat liquor produced out of state the same as its domestic equivalent.

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[8] *Granholm*, 544 US at 488-489.

B. Michigan's One-Year Residency Requirement For Wine Wholesalers Was Not Properly Raised or Preserved Below and Does Not Violate the Commerce Clause.

In the State courts below, Petitioners did not properly raise and preserve a challenge to the residency requirement of MCL 436.1601. To the contrary, they expressly disavowed such a challenge[9]:

> [P]laintiffs have not properly challenged the one-year residency requirement of MCL 436.1601(1). At oral arguments, plaintiffs' counsel stated, "We have not challenged [§ 601(1)] nor do we think it is critical to our case." Further, whether plaintiffs would have standing to challenge the residency requirement of § 601 is questionable given that National Wine & Spirits, L.L.C., is a Michigan resident and a licensed wine wholesaler in Michigan. As plaintiffs' counsel acknowledged at oral argument, when asked why they had not challenged the residency requirement of § 601, "[B]ecause we are operating now. We have met the residency requirement . . . ."

Petitioners frequently refer to National Wine & Spirits LLC as an out-of-State wholesaler. It is no such thing. It is a licensed Michigan resident wine wholesaler. Petitioners did not challenge the one-year

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[9] Michigan Supreme Court order denying reconsideration, Markman, J., concurring, 477 Mich at 1089; 729 NW 2d at 235-236 (2007) (Pet. App. 17-18)

residency requirement for a wine wholesaler license when Petitioner National Wine & Spirits LLC became a wine wholesaler in 1999. Petitioners did not challenge the constitutionality of MCL 436.1601 in the trial court. Its real complaint is that it didn't commence business until after 1996 and now seeks to retroactively change residency and geographic distribution requirements that had existed long before then.

Even if the residency requirement for wine wholesalers had been properly challenged by Petitioners, this Court has twice recently confirmed that under the Twenty-first Amendment, States can require their wholesalers to be in-State residents[10]:

> We have previously recognized that the three-tier system itself is 'unquestionably legitimate.' *North Dakota v United States,* 495 US, at 432, 110 S Ct 1986. See also *id,* at 447, 110 S Ct 1986 (Scalia, Jr., concurring in judgment) ('The Twenty-first Amendment . . . empowers North Dakota to require that *all liquor sold for use in the State be purchased from a licensed in-state wholesaler*'). State policies are protected under the Twenty-first Amendment when they treat liquor produced out of state the same as its domestic equivalent."

The residency requirement is not properly an issue in this case since it was not challenged when Petitioner NWS Michigan became an ADA and it was not challenged in the courts below. But even

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[10] *Granholm*, 544 US at 489. (Emphasis added.)

assuming, incorrectly, that it is somehow relevant, MCL 436.1601 did not prevent National Wine & Spirits LLC from becoming a wine wholesaler prior to September 24, 1996. National Wine & Spirits LLC had the ability to become a wine wholesaler in 1950, 1975, 1985, or at any other time prior to the date chosen by the Michigan Legislature, just as it was able to become a wine wholesaler in 1999.

The residency requirement does not impose any "dualing" limitations on Petitioners. If Petitioner National Wine & Spirits LLC, as a wine wholesaler, wants to be free of all restrictions on "dualing," it can do so simply by ceasing to be an ADA for the State. It will then have the same "dualing" rights as any other wine wholesaler who is not an ADA. It is only because National Wine & Spirits, LLC wants to act *both* as a State agent (an ADA) for spirits and a wine wholesaler, that the dualing restrictions apply.

C. When The Michigan Legislature Created The ADA Licensing Structure For Distribution Of Spirits In 1996, It Legitimately Took Into Account Existing Economic Reliance Interests And Retained The Residency And Geographic Distribution Requirements For Wine Wholesalers.

Petitioner National Wine & Spirits LLC argues that in 1996, before it became an ADA/wholesaler, other wine wholesalers already were distributing some brands in some areas. In 1996, when it created the ADA structure, the Michigan Legislature decided to allow existing wine wholesalers to "dual"—but only where they already did business—even if they later became ADAs. The Michigan Legislature recognized

economic reliance interests and permitted existing licensed wine wholesalers to continue their appointments in their assigned geographic areas, even if the appointing winery had another wholesaler in that same territory or later appointed one. The Legislature also attempted to level the playing field for existing wine wholesalers and new ADA/wholesalers by generally prohibiting new ADA/wholesalers from becoming wine wholesalers in territories with existing wine wholesaler appointments. It is this feature of the statute, this "grandfather clause," that Petitioners argue is an impermissible burden on interstate commerce under the dormant Commerce Clause.

In the Michigan Court of Appeals Petitioners argued that the grandfather clause gave existing wine wholesalers an additional benefit, but the Court rejected that argument and concluded that the Legislature had a rational basis for protecting existing economic reliance interests when it created the new ADA structure[11]:

> We conclude that the classification based on date is rationally related to defendant's purpose. Before 1996, there were no ADAs because the distribution of alcohol was handled solely by Michigan's Liquor Control Commission. After defendant allowed ADAs to distribute alcohol, it realized that ADAs receiving state subsidies that were also wine wholesalers had an unfair economic advantage over wine wholesalers that were not ADAs. In order to prevent this specific

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[11] *National Wine & Spirits v State of Michigan*, 2004 Mich App Lexis 830, unpublished opinion at 13-14; Pet. App at 9-10.

> unfair advantage, it decided to preclude ADA/wholesalers from dualing. But because some ADA/wholesalers already had dualing agreements, defendant did not take away their pre-existing right to dual. . . .
>
> * * * Rather than penalizing a wine wholesaler that already had a dualing agreement when/if it became an ADA, the Legislature allowed the wine wholesaler to continue to operate under their preexisting agreement.

This Court has made similar rulings upholding statutory "grandfather" clauses in many cases. It reviewed some of them in *Nordlinger v Hahn* and said[12]:

> This Court previously has acknowledged that classifications serving to protect legitimate expectation and reliance interests do not deny equal protection of the laws. 'The protection of reasonable reliance interests is not only a legitimate governmental objective: it provides an exceedingly persuasive justification. . . .' (internal quotations omitted). *Heckler* v. *Mathews*, 465 US 728, 746; 79 L Ed 2d 646; 104 S Ct 1387 (1984).

Petitioner National Wine & Spirits LLC argued below that the crux of its claim was MCL 436.1205(3)'s distinction between wine wholesalers who were in

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[12] *Nordlinger v Hahn*, 505 US 1, 13 (1992)(footnote citing cases in other contexts omitted).

business on the "grandfather" date and those who were not, if they later became ADAs. But *Nordlinger* recognizes that protecting such "reasonable reliance interests" is not only "legitimate" but is "an exceedingly persuasive justification" for a statute like Michigan's. Whether out-of-State or in-State, any ADA/wholesaler is subject to the prohibition on dual wine wholesaling appointments. Any ADA getting into the wholesale wine business will receive equally the statute's benefits and burdens, from that day forward.

Petitioners argue that no foreign corporation could have had any distribution appointments on September 24, 1996, because the Act forbade licensing for distribution by any but persons resident in Michigan. Petition, at 15-16. But National Wine & Spirits LLC didn't even attempt to become a wine wholesaler until three years later, and was licensed then. Michigan has many companies, domestic and foreign, that were not licensed wine wholesalers in 1996. They may apply for wine wholesale distribution licenses. They will then be protected by the anti-dualing statute, while themselves being permitted to accept dual appointments. They may apply also for appointment as ADAs. They will then be subject to the anti-dualing rule, just as National Wine & Spirits LLC and all other ADA/wholesalers are. No discrimination against out-of-State entities exists. And as demonstrated by National Wine & Spirits LLC itself, Michigan does not prohibit out-of-State companies from operating as wholesalers through a subsidiary.

As in *Nordlinger*, it was rational and "legitimate" to extend the requirements of the statute to new entrants, but it is not required that they be put on an equal footing with established owners.

D. The Legislature May Structure Michigan's "Unquestionably Legitimate" In-State Alcoholic Beverage Distribution System

Wine wholesalers who do not become ADA/wholesalers may seek and accept dual appointments for any areas, regardless of whether other wine wholesalers have appointments there. Only ADA/wholesalers are forbidden to get wine wholesaler appointments under some circumstances. This is a legislative compromise like the compromise validated by this Court in *United States Railroad Retirement Bd v Fritz*[13]: "[b]ecause Congress could have eliminated windfall benefits for all classes of employees, it is not constitutionally impermissible for Congress to have drawn lines between groups of employees for the purpose of phasing out those benefits."

The Michigan Legislature could have erected a complete barrier between distributors of liquor and wine wholesalers, or it might have permitted dualing without limit. Choices like that are uniquely suited to the Legislature, which is charged with balancing competing interests. This is especially true with regard to alcoholic beverage distribution within a State, as the Twenty-first Amendment gives States the right to determine the structure of the in-State distribution system: "'The problems of government are practical ones and may justify, if they do not require,

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[13] *United States Railroad Retirement Bd v Fritz*, 449 US 166, 177 (1980).

rough accommodations—illogical, it may be, and unscientific.'" [14]

Petitioners are free to seek amendment of the statute and its history demonstrates that the Legislature will attend to concerns about the statute's reach.[15]

The legislative concerns reflected in the structure of Michigan's alcoholic beverage systems, including the regulation of dual appointments and the geographic limitations on distribution are "unquestionably legitimate" since they "treat liquor produced out of the State the same as its domestic equivalent."[16] The Michigan alcohol distribution structure does not violate the Commerce Clause.

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[14] *Fritz*, 449 US at 175, citing and quoting from *Metropolis Theatre Co v City of Chicago*, 228 US 61, 68-70 (1913). See also *Granholm*, 544 US at 489.

[15] MCL 436.1205 was originally enacted in 1996, as MCL 463.3a(3): 1996 PA 440. It was re-enacted without change by 1998 PA 58 as MCL 436.1205(3). Only five years after the original enactment, the Michigan Legislature made substantial changes in MCL 436.1205(3): 2001 PA 274.

[16] *Granholm*, 544 US at 489.

CONCLUSION

This Court should deny the petition for a writ of certiorari.

Respectfully submitted,

Michael A. Cox
Michigan Attorney General

Thomas L. Casey
Michigan Solicitor General
Counsel of Record
P. O. Box 30212
Lansing, Michigan 48909
(517) 373-1124

Howard E. Goldberg
Assistant Attorney General.

Attorneys for Respondent
State of Michigan

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